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Cases, Regulations and Statutes

Robert P. Achenbach Jr.
Agricultural Law Press, robert@agrilawpress.com

scheme, to create a widespread exclusion for the food and housing expenses of agricultural and ranch owners who happen to organize their business under Subchapter S. Indeed if this were true, then one would expect all ranchers and farmers to organize under Subchapter S and exclude all their housing and lodging expenses from their income. This would hardly be a fair result unless all business owners who must live in the city to be near their business for a variety of reasons were allowed to deduct their food and lodging expenses as well. Such a result is unthinkable and this Court will not construe the IRC to reach this outcome."

Although only dictum, this passage demonstrates that the *Dilts* court fundamentally misunderstands both the corporate structure and the statutory provisions under I.R.C. § 119. Certainly, a farm corporation can and does have employees and, if it is a C corporation, the employees have long been entitled to exclude the value of meals and lodging from income. The court in *Dilts* reached the correct conclusion but, unfortunately, in careless dictum has improperly cast doubt on the handling of meals and lodging by farm and ranch corporations. The slap at *Wilhelm v. United States* [24] was gratuitous and unnecessary. That case was decided long before either of the limitations was enacted for S corporations on the handling of meals and lodging.

FOOTNOTES

1 See I.R.C. § 119. See generally 7 Harl, *Agricultural Law* § 57.03[2] (1994).

2 *Id.*

3 See I.R.C. §§ 280A(a), (c), 1372.

4 Dilts v. U.S., 94-1 U.S.T.C. ¶ 50,162 (D. Wyo. 1994).

5 I.R.C. § 119.

6 I.R.C. § 119 (a)(1).

7 I.R.C. § 119(a)(2). See Crowe v. U.S., 4 Cls. Ct. 734 (1984); Ltr. Rul. 8826001, Oct. 14, 1987 (value of housing provided by employer included in employees' income when housing not provided at work site and not provided in one "camp" but scattered within housing generally available to public); Ltr. Rul. 9126063, March 29, 1991 (value of off-premises lodging and utilities included in gross income).

8 Rev. Rul. 68-579, 1968-2 C.B. 61. See Harrison v. Comm'r, T.C. Memo. 1981-221 (amounts for gas and electricity paid by corporation in grain and dairy operation were necessary for residences to be habitable and so excludable from income of employees). See also Vanicek v. Comm'r, 85 T.C. 731 (1985), *acq*., 1986-1 C.B. 1 (portion of cost of utilities for residence provided by employer not deductible because of lack of evidence by which utility costs could be apportioned between business and personal use).

9 Greene v. Kanne, 38-1 U.S.T.C. ¶ 9206 (D. Hawaii 1938) (value of quarters provided to plantation manager not taxable); Renton v. Kanne, 38-1 U.S.T.C. ¶ 9207 (D. Hawaii 1938)(same); Wilhelm v. U.S., 257 F. Supp. 16 (D. Wyo. 1966) (value of food and lodging provided by ranching corporation not taxed to shareholder-employees); Caratan v. Comm'r, 442 F. 2d 606 (9th Cir. 1971) (Commissioner not sustained in adding $1200 to gross income of each stockholder-employee of closely-held corporation who lived in corporation-owned house on business premises); J. Grant Farms, Inc. v. Comm'r, T.C. Memo. 1985-174 (swine raising and grain drying operation; value of lodging and utilities excluded from income); Johnson v. Comm'r, T.C. Memo. 1985-175 (husband-wife, sole shareholders, allowed exclusion from income of fair rental value of corporation-owned residence on premises when husband was manager of corporation's grain drying and storing operation).

10 Roberts v. Comm'r, 17 P-H Tax Ct. Mem. 516 (1948) (rental value of corporate-owned farm house occupied by sole shareholder of farm corporation was taxable income).

11 Peterson v. Comm'r, T.C. Memo. 1966-196 (poultry breeding operation).

12 I.R.C. § 280A(a), (c). See Proskauer v. Comm'r, T.C. Memo. 1983-395.

13 *Id*.

14 I.R.C. § 119.

15 I.R.C. § 1372.

16 94-1 U.S.T.C. ¶ 50,162 (D. Wyo. 1994).

17 *Id*.

18 394 F.2d 661 (5th Cir. 1968).

19 See n. 15 *supra.*

20 See n. 17 *supra.*

21 I.R.C. § 280A(a), (c).

22 257 F. Supp. 16 (D. Wyo. 1966).

23 94-1 U.S.T.C. ¶ 50,162, n. 7 (D. Wyo. 1994).

24 257 F. Supp. 16 (D. Wyo. 1966).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

HORSES-*ALM* § 1.01[2].* The plaintiff was injured when the plaintiff's automobile struck a mare owned by the defendant. The defendant lived on the farm but worked in a nearby city and often spent several days away from the farm. The defendant hired a worker to feed the horses but the worker quit without notice several days before the accident. Although the horses were kept in a fenced corral and barn, the horses escaped and one wandered onto the highway and was struck by the plaintiff's car. The plaintiff claimed that the defendant was negligent in failing to properly confine the horse and in failing to hire a responsible and careful worker. The plaintiff also claimed that the defendant was negligent because the defendant, through the worker, had constructive knowledge of the escape of the horses. The court held that the evidence showed that the defendant had no knowledge of the escape until after the accident and that the worker quit before the escape; therefore, the defendant had no prior actual or constructive knowledge of the escape. The court also held that the defendant used sufficient means of containing the horses and that the plaintiff failed to show how the horses escaped through any negligence of the defendant. The court held that if the worker let the horses escape when the worker quit, the defendant was not liable because the worker's actions were outside the scope of the employment and the plaintiff failed to show that the defendant knew or should have known that the worker would take such actions. **Briggs v. Finley, 631 N.E.2d 959 (Ind. Ct. App. 1994)**.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

AVOIDABLE LIENS. The debtor was a buyer of agricultural commodities for resale and had purchased commodities for which payment had not been made. The debtor had granted a security interest in the produce to a creditor. The bankruptcy trustee sought to avoid the security interest in the produce as violating the Perishable Agricultural Commodities Act (PACA), 7 U.S.C. § 499e(c). The court held that the statute did not void all such security interests as to everyone but only as to commodity producers who had perfected their rights in the PACA trust as to produce for which no payment had been received. The court held that the trustee could not use the PACA trust provisions to avoid a security interest in the produce because the trustee had no rights in the PACA trust. ***In re* N. Merberg & Sons, Inc., 166 B.R. 567 (Bankr. S.D. N.Y. 1994)**.

A creditor had attached a judicial lien against the debtor's homestead in which the debtor had no equity. The debtor sought to avoid the judicial lien as impairing the homestead exemption but the creditor objected on the basis that the judicial lien secured a nondischargeable debt because of the debtor's willful and malicious actions. The court held that the dischargeability of the debt secured by the judicial lien did not affect the avoidability of the debt and that the judicial lien was avoidable even though the debtor had no equity in the homestead. ***In re* Ash, 166 B.R. 202 (Bankr. D. Conn. 1994)**.

The debtors sought avoidance of judicial liens against their homestead which they claimed as exempt under Ohio Rev. Code § 2329.66(A)(1). The court held that under the Ohio exemption, the exemption was allowed only as against "execution, garnishment, attachment or sale" and thus did not provide any exemption in a bankruptcy case. Therefore, no exemption was impaired by the judicial liens and the liens could not be avoided. ***In re* Moreland, 21 F.3d 102 (6th Cir. 1994), *rev'g*, 142 B.R. 221 (Bankr. S.D. Ohio 1992)**.

AVOIDABLE TRANSFERS. Prior to the filing of the bankruptcy petition, a secured creditor had foreclosed on the debtor's real property and the property was sold at an auction which met the state law requirements for foreclosure sales and was neither collusive nor fraudulent. However, the sale produced proceeds of less than 50 percent of the claimed fair market value of the property. The debtor sought to avoid the foreclosure sale under Section 548(a)(2) as not for "reasonably equivalent value." The court held that a foreclosure sale which met the state law requirements for a foreclosure sale conclusively met the Section 548(a)(2) requirement of "reasonably equivalent value." **BFP v. Resolution Trust Corp., 114 S.Ct. 1757 (1994)**.

EXEMPTIONS

HOMESTEAD. The debtor filed a Chapter 7 petition and claimed a homestead exemption. The debtor died two weeks after the petition was filed and no family member continued to live in the house. The trustee objected to the exemption because of the death of the debtor. The court held that the exemption was determined as of the date of the petition and allowed the exemption. **In re Combs, 166 B.R. 417 (Bankr. N.D. Cal. 1994)**.

CHAPTER 12-*ALM* § 13.03[8].*

TRUSTEE FEES-*ALM* § 13.03[8]. During the administration of the debtor's Chapter 12 plan, the Attorney General set the trustee's fee at 11.111111 percent of all plan payments. The rate was based on the interpretation of 28 U.S.C. § 586(e)(1) to include payment of the trustee's fees as a plan payment also subject to the trustee fee. Thus, the maximum rate of 10 percent was charged against the debtor's payments of the trustee's fees. The Bankruptcy Court held that the 11.111111 percent rate exceeded the statutory maximum of 10 percent and ordered return of fees assessed in excess of 10 percent. The appellate court reversed, holding that because the statute was ambiguous, the Attorney General's interpretation was to be given deference. ***In re* BDT Farms, Inc., 21 F.3d 1019 (10th Cir. 1994), *rev'g unrep. D. Ct. dec. aff'g*, 152 B.R. 642 (Bankr. W.D. Okl. 1993), *aff'g on recon*., 150 B.R. 795 (Bankr. W.D. Okl. 1993)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

ABANDONMENT. The debtor's filing for Chapter 7 stayed a pending state court action for replevin by a creditor with a security interest in the debtor's farm machinery. The bankruptcy trustee moved to abandon the machinery to the debtor. The debtor objected because the debtor's income tax basis in the machinery was zero and a sale of the machinery would result in over $18,000 in taxable gain to the debtor. The debtor asked that the machinery be abandoned directly to the creditor in the hope that the creditor or bankruptcy estate would be charged with the taxable gain. The court held that the abandonment of the machinery to the debtor would not result in any recognition of gain under I.R.C. § 1398(f)(2) and that the abandonment had to be to the debtor because the debtor held the highest possessory interest in the property on the date of the bankruptcy filing. **Matter of Popp, 166 B.R. 697 (Bankr. D. Neb. 1993)**.

AUTOMATIC STAY. The debtor had failed to file income tax returns for ten years. The IRS filed substitute returns and made assessments based on those returns. The IRS attempted to levy on the debtor's residence but the sale of the house was prevented by the debtor filing a Chapter 11 case. The IRS again attempted the sale when the debtor dismissed that case but the debtor filed the instant case the day before the scheduled sale. After the case was one year old, the IRS moved for relief from the automatic stay to sell the house, arguing that the debtor had abused the bankruptcy process in order to prevent the sale. The debtor argued that relief from the stay was prohibited because the IRS was adequately protected since the house was worth more than the levy amount. The debtor failed to provide any proof of the value of the house. The court held that relief from the automatic stay could be granted "for cause," including abuse of the bankruptcy process and that the debtor's failure to file income tax returns and the multiple filings just before the sales indicated that the filings were intended only to thwart the IRS. **I.R.S. v. Bacha, 166 B.R. 611 (Bankr. D. Md. 1993)**.

CLAIMS. The IRS filed an untimely claim which was partially secured and partially unsecured. The Bankruptcy Court had allowed only the secured portion of the claim and disallowed the unsecured portion as untimely filed. The appellate court affirmed. **U.S. v. Clark, 166 B.R. 446 (D. Utah 1993)**.

PRIORITY TAX CLAIMS. The debtor received a pre-petition reversion of amounts in a retired employee pension plan and the IRS assessed the excise tax under I.R.C. § 4980(a). The IRS filed a claim for the taxes as a priority tax claim and the other creditors objected, arguing that the tax was actually a penalty not entitled to the priority of 11 U.S.C. § 507(a)(7). The court held that the excise tax was a penalty because it was assessed without reference to the tax benefits received by the debtor from the pension plan; therefore, the tax claim was not entitled to a priority. The court also agreed to subordinate the tax claim to other unsecured claims to avoid the inequity of the burden on the unsecured creditors. ***In re* Juvenile Shoe Corp. of America, 166 B.R. 404 (Bankr. E.D. Mo. 1994)**.

TURNOVER. The debtors had requested their employers to withhold excess federal income tax from their wages for 1990. On their 1990 income tax return, the debtors requested the IRS to apply the excess taxes to their 1989 tax liability; however, the IRS applied the refund to an assessment for 1986 even though the debtors were not aware of any assessment for that taxable year. The IRS then filed a claim in the bankruptcy court for the 1989 taxes, penalties and interest. The court held that the IRS was required to apply the voluntary payment of taxes as requested by the taxpayers and that the improper "seizure" of the refund was subject to turnover to the bankruptcy estate. The 1989 taxes would still remain a valid claim but the 1986 taxes were dischargeable, for other reasons. ***In re* Ryan, 166 B.R. 757 (Bankr. S.D. Ala. 1993)**.

CONTRACTS

PURCHASE PRICE. The plaintiff was a watermelon producer who sold watermelons through the defendant produce broker during the summer of 1992. At the beginning of the season the parties orally agreed to a 3 cents per pound price for the melons. During the summer the price of melons dropped to 2 1/2 cents per pound but the parties did not specifically discuss the lower price until the end of the season when the accounts were settled. The plaintiff argued that the agreement for 3 cents per pound was to apply for the whole season and applied to loaded weight. The defendant showed that the historical practice of the parties was that the price could and often did fluctuate, especially late in the season, and that the weight was determined by the delivery weight. The court held that the trial court's judgment for the defendant was supported by evidence of the course of conduct of the parties to determine the contract price for the melons. The court treated each load of melons as a separate contract with the purchase price fluctuating by the market price of melons. **Zolman v. Semo Produce, Inc., 875 S.W.2d 605 (Mo. Ct. App. 1994)**.

FEDERAL AGRICULTURAL PROGRAMS

AGRICULTURAL LABOR-*ALM* § 3.02.* The plaintiffs were migrant seasonal agricultural workers hired by one of the defendants, the contractor, to work on another defendant's, the farm owner's, vegetable farm under a contract between the contractor and the farm owner. The plaintiffs argued that the farm owner was a joint employer with the contractor and, as such, was jointly liable for violations of the Migrant and Seasonal Agricultural Worker Protection Act (MSAWPA). The court held that the five factors of employment contained in 29 C.F.R. § 500.20(h)(4)(ii) and another six factors found in judicial precedent could be used to determine whether the farm owner was a joint employer with the contractor. In reviewing the five regulatory factors, the court held that the farm owner did not have sufficient control over the workers because the farm owner only contracted for a specific number of workers and had no choice over which workers were hired or fired. The farm owner's choice of fields to work did not amount to control over the workers. The court also held that the farm owner did not exercise sufficient control over the method of work to be considered a joint employer because the farm owner provided only de minimis supervision. The plaintiffs argued that the farm owner had control over the amount the plaintiffs were paid, but the court held that the amount paid by the farm owner to the contractor was reached by arm's length negotiations between the farm owner and the contractor who had independent discretion as to how much of the payments were then paid to the plaintiffs. The court held that the other factors did not apply or were conceded by the plaintiffs to not support a finding that the farm owner was an employer; therefore, the farm owner was not held to be an employer subject to MSAWPA. **Aimable v. Long & Scott Farms, 20 F.3d 434 (11th Cir. 1994)**.

BORROWER'S RIGHTS-*ALM* § 11.01[2][g].* The debtor lost a farm on a foreclosure sale to the FmHA. While the farm was in the FmHA inventory, the FmHA declared a wetland's easement on more than half of the farm. The FmHA sold the farm to the debtor at a price reduced to reflect the loss of value from the wetland's easement. After the debtor was unable to produce sufficient income from the farm to meet the purchase payments, the debtor sought removal of the wetland's easement as an unlawful cloud on the title. The court held that the wetlands easement was allowed under Executive Order 11990 which was not prohibited by the subsequent Agricultural Credit Act of 1987 or the Food Security Act of 1985 which established the lease/buyback program. The court also held that an issue of fact remained as to whether the wetlands were in fact wetlands when the FmHA acquired the property or were

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changed to become wetlands while in the FmHA possession. **Harris v. U.S., 19 F.3d 1090 (5th Cir. 1994), *aff'g*, 820 F. Supp. 1018 (N.D. Miss. 1992)**.

FARM CREDIT SYSTEM-*ALM* § 11.01[2].* The case was removed to federal court based upon the claim that the Federal Debt Collection Act (FDCA) applied to an issue raised in the case. The court held that Section 203(b) of the Farm Credit Act of 1959 stated that subsequent acts of Congress would not apply to the Farm Credit System banks unless the acts specifically mentioned the member banks. Because the FDCA did not specifically mention the defendant farm credit bank as subject to its provisions, the FDCA did not apply to the defendant and no federal issue was involved in the case; therefore, the case was remanded to the state court. **Agribank, FCB v. Bergman, 847 F. Supp. 118 (S.D. Ill. 1994)**.

PESTICIDES-*ALM* § 2.04.* The plaintiff distributed and sold a product called DLT Mound Leveler to be used to control fire ant mounds. The EPA had determined that the product was a pesticide and a state court had determined that the product was a pesticide. The EPA issued an order that the plaintiff cease to distribute and sell the product because the product was not licensed under FIFRA. The plaintiff filed a federal suit to enjoin the EPA from preventing the distribution and sale of the product, claiming that the product was not a pesticide. The court held that FIFRA did not provide a private right of action to review actions by the EPA as to pesticides and that the plaintiff was estopped from denying that the product was a pesticide by the state court judgment. **Turner v. E.P.A., 848 F. Supp. 711 (S.D. Miss. 1994)**.

TUBERCULOSIS. The APHIS has issued proposed regulations changing the designation of Virginia from an accredited-free state to an accredited-free (suspended) state. **59 Fed. Reg. 31921 (June 21, 1994)**.

FEDERAL ESTATE AND GIFT TAX

CHARITABLE DEDUCTION-*ALM* § 5.04[4].* The decedent's will bequeathed property to four trusts which had charitable organizations as partial remainder holders. The trusts would have qualified as charitable remainder trusts except that the trusts did not provide a fixed annual distribution for the current beneficiary. The executor sought a state court reformation of the trusts to provide a fixed annual payment to the beneficiaries. The IRS ruled that the reformation would qualify the trusts for the charitable deduction for the decedent's estate. **Ltr. Rul. 9422043, March 4, 1994**.

DISCLAIMERS-*ALM* § 5.02[6].* The surviving spouse and decedent had established a revocable trust in 1990 funded with community property, with the surviving spouse and decedent as beneficiaries and trustees. At the decedent's death, the surviving spouse removed all of the surviving spouse's share of the trust corpus from the trust and disclaimed any right or power over the decedent's share of the trust property, including the right to revoke or amend the trust, the right to change the beneficiary and the right to withdraw any property from the trust corpus; however, the surviving spouse did not disclaim the income interest in the trust. The surviving spouse had not exercised any power over the trust corpus other than as successor trustee and the disclaimer caused the disclaimed trust interests to pass to other beneficiaries under the terms of the trust. The IRS ruled that the disclaimer was qualified under I.R.C. § 2518. **Ltr. Rul. 9424023, March 15, 1994**.

An irrevocable trust was created by a husband and wife in 1935, with the son as sole beneficiary and remainders in the son's heirs. The son was still alive and had a general power of appointment over the son's beneficial interest in the trust, but if the son failed to exercise the power, the trust passed to the son's spouse and children. One of the children planned to disclaim, either before the son's death or within nine months after the son's death, any beneficial interest in the trust which would pass to the child at the son's death if the son failed to exercise the power. The child's interest would then pass under the terms of the trust to the other heirs. The IRS ruled that the son's power of appointment was created prior to 1942 and the lapse of the power would not be a taxable transfer. The IRS also ruled that the child's disclaimer of the beneficial interest, either before the son's death or within nine months after the son's death, would be a qualified disclaimer. The IRS also ruled that the release or lapse of either the son's or the child's power of appointment would not subject the trust to GSTT because neither release or lapse was a taxable transfer. **Ltr. Rul. 9424062, March 23, 1994; Ltr. Rul. 9424063, March 23, 1994**.

GENERATION SKIPPING TRANSFER TAX-*ALM* § 5.04[6].* On the decedent's death, the decedent held a lifetime income interest in an irrevocable marital trust established by the decedent's predeceased spouse in 1974. The decedent held a testamentary general power of appointment over the trust corpus but did not exercise the power and the trust corpus passed to the predeceased spouse's grandchildren. The court held that the trust was subject to GSTT because the decedent's failure to exercise the general power of appointment was a constructive addition to the trust occurring after the effective date of the GSTT. The court also held that the application of GSTT to the trust did not violate the due process clause of the U.S. Constitution because the tax resulted from the decedent's actions after enactment of GSTT and did not violate the equal protection clause because a rational basis supported application of the tax to the decedent's actions. **E. Norman Petersen Marital Trust v. Comm'r, 102 T.C. No. 38 (1994)**.

An irrevocable trust was established in 1956 which provided for distribution of income to a charitable organization until 21 years after the death of certain family members alive on the date the trust was established. If the annual income was less than 3 1/2 percent of the value of the trust assets, the difference was to be paid from principal. The trust had several years when trust principal was distributed in order to make a 3 1/2 percent distribution and the trustees had not recouped the principal in later years when income exceeded 3 1/2 percent. The beneficiaries executed codicils to their wills exercising a testamentary power of appointment which passed any deficiency amount to the charitable organization. One beneficiary died, making the codicil irrevocable, and the other beneficiary executed a contract to make the codicil irrevocable. The IRS ruled that the codicils and contract did not subject the trust to GSTT. **Ltr. Rul. 9423018, March 11, 1994**.

A decedent's will in 1955 established a trust for the decedent's children and three grandchildren. At the present time only the three grandchildren survive and the beneficiaries divided the trust into three identical trusts, except that some non-pro rata division of assets occurred. The original trust provided for an investment counselor and the three trusts would allow the beneficiary, as co-trustee, to hire an investment counselor to be paid from trust assets. Neither the trust nor state law allowed for non-pro rata distributions. The IRS ruled that no gain or loss would be recognized from the division of the trust except to the extent of any non-pro rata division of assets. The IRS also ruled that the division of the trust and the hiring of investment counselors would not subject the trust to GSTT. **Ltr. Rul. 9424026, March 16, 1994**.

A decedent's will in 1973 established trusts for the decedent's children and grandchildren. The decedent's will did not expressly provide whether income that was not distributed in a given year was to be available for future distributions or to be added to corpus. Without advocating either interpretation, the trustees sought a state court construction of the will on this issue. The trustees also sought modification of provisions governing compensation of the trustees and the procedures for appointment and removal of trustees. The IRS ruled that the judicial construction of the will and the trust modifications would not subject the trust to GSTT. **Ltr. Rul. 9424048, March 22, 1994**.

GIFT-*ALM* § 6.01.* In 1967, the decedent amended a 1967 will but mistaken omitted a class of beneficiaries originally included in the 1967 will. After the decedent's death, the beneficiaries of several family trusts created by the will agreed to reinstate the omitted beneficiaries but the trusts were not finally reformed until after a settlement reached in a law suit brought by the beneficiaries. The IRS ruled that the final settlement was consistent with the valid rights of the parties under the will and state law; therefore, the settlement did not produce any taxable gifts to the readmitted beneficiaries. The IRS also ruled that the settlement did not subject the trusts to GSTT. **Ltr. Rul. 9423015, March 9, 1994**.

SPECIAL USE VALUATION-*ALM* § 5.03[2].* The decedent owned a 26 percent limited partnership interest in a cattle ranch. The estate elected to value the decedent's interest in the partnership land using special use valuation but decreased the value of the decedent's interest in the land by a 30 percent minority discount before applying the maximum special use valuation reduction. The court held that the estate could not claim a minority discount if a special use valuation election is made. **Est. of Hoover v. Comm'r, 102 T.C. No. 36 (1994)**.

TRUSTS. Fla. Stat. § 737.402(4), effective for irrevocable trusts in existence before and after enactment of the statute, provides that any fiduciary power conferred upon a trustee to make discretionary distributions of either principal or income to or for the trustee's own benefit could not be exercised by the trustee except to provide for that trustee's health, education, maintenance or support or except where the trustee is the grantor or the grantor's spouse. The IRS ruled that the statute was ineffective for federal estate and gift tax purposes to change the rights of any party in interest in a trust before the date of the statute's enactment if federal estate or gift tax consequences have already attached to the rights. **Rev. Proc. 94-44, I.R.B. 1994-28**.

VALUATION-*ALM* § 6.01[6].* The taxpayers, husband and wife, transferred their residence to a 30-year trust. The trust provided that the taxpayers retained the right to use the residence as their personal residence during the term of the trust and allowed the taxpayers to either rent or purchase at fair market value the residence from the remainder beneficiaries after the termination of the trust. If either spouse dies, the deceased spouse's interest passes from the trust to the surviving spouse. If both taxpayers die before the termination of the trust, the residence passes to the remainder beneficiaries, the taxpayers' children. The IRS ruled that the trust was a qualified personal residence trust for purposes of I.R.C. § 2702. **Ltr. Rul. 9425029, March 28, 1994**.

FEDERAL INCOME TAXATION

ACCOUNTING METHOD. The IRS has issued procedures to be used to obtain expeditious consent to change methods of accounting for costs subject to I.R.C. § 263A to methods allowed under the regulations. Compliance with the procedures results in the taxpayer being deemed to have obtained the consent of the Commissioner to the changes. The procedures also modify Rev. Proc. 92-20, 1992-1 C.B. 685 governing changes during a taxpayer's first or second taxable year. **Rev. Proc. 94-49, I.R.B. 1994-30**.

C CORPORATIONS

CONSTRUCTIVE DISTRIBUTIONS. The IRS has issued proposed regulations governing constructive distributions on preferred stock redeemable at a premium by the issuer at the discretion of the issuer. **59 Fed. Reg. 32160 (June 22, 1994)**.

DISCHARGE OF INDEBTEDNESS-*ALM* § 4.02[15].* The taxpayers transferred farmland and cash to a creditor in partial satisfaction of indebtedness with the creditor forgiving the remainder of the debt. The value of the farmland exceeded its basis to the taxpayers and the taxpayers were insolvent before and after the debt forgiveness. The court held that although the discharge of indebtedness income realized from the debt forgiveness (determined using the land's fair market value) was not income to the taxpayers, the gain from the difference between the land's fair market value and the taxpayers' basis in the land was taxable income. **Note**: the result can be illustrated graphically as follows:

Not taxable | Gain | Discharge of indebtedness

0 | Basis | FMV | Debt

Gehl v. Comm'r, 102 T.C. No. 37 (1994).

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PENSION PLANS. For plans beginning in June 1994, the weighted average is 7.26 percent with the permissible range of 6.53 to 7.98 percent for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 94-71, I.R.B. 1994-26, 14**.

The IRS has adopted as final regulations amending the compensation limit for tax-qualified retirement plans under I.R.C. § 401(a)(17). **59 Fed. Reg. 32903 (June 27, 1994)**.

The IRS has adopted as final regulations under I.R.C. § 414(r) implementing the provision that an employer may be treated as operating separate lines of business for purposes of applying the minimum coverage requirements of I.R.C. § 410(b). **59 Fed. Reg. 32911 (June 27, 1994)**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

DISCHARGE OF INDEBTEDNESS. The taxpayer was a shareholder in an S corporation which was insolvent during the taxable year in which indebtedness was discharged in a debt restructuring agreement with the corporation's creditor. The taxpayer argued that the discharge of indebtedness income was tax-exempt income and increased the basis of the taxpayer's stock before the corporation reduces its tax attributes by the amount of the discharge of indebtedness income. The IRS ruled that the nonrecognition rules of I.R.C. § 108(b) operated only at the S corporation level and did not result in any pass-through of income to the shareholders or increase of stock basis. Instead, the corporation reduces its tax attributes by the amount of discharge of indebtedness income before effecting any pass-through of corporation income or deduction to the shareholders. **Ltr. Rul. 9423003, Feb. 28, 1994**.

NUMBER OF SHAREHOLDERS. In *Rev. Rul. 77-220, 1977-1 C.B. 263*, 30 individuals formed a business and established three corporations of 10 shareholders each in order to qualify for S corporation status. The business was operated by a partnership composed of the three corporations. In *Rev. Rul. 77-220*, the IRS had ruled that the corporations would be deemed one corporation not eligible for the S corporation election because the total number of shareholders exceeded the maximum allowed (10). The IRS has revoked *Rev. Rul. 77-220* and now recognizes the corporations as separate for purposes of determining the number of shareholders. **Rev. Rul. 94-43, I.R.B. 1994-27**.

TRAVEL EXPENSES. In response to *Walker v. Comm'r, 101 T.C. 537 (1993)* (logger allowed travel costs deductions for travel between residence and temporary work sites), the IRS has ruled that it will not follow *Walker* where the taxpayer's personal residence is not the principal place of business and has issued three guidelines for deductibility of travel costs from a residence to temporary work sites: (1) daily transportation costs between a residence and temporary work sites outside of the metropolitan area of the residence are deductible and such costs for sites in the same metropolitan area are not deductible; (2) if the taxpayer has more than one regular place of business, daily transportation costs to temporary work sites are deductible, wherever located: and (3) if the residence is the principal place of business, daily transportation costs to regular or temporary work sites are deductible. **Rev. Rul. 94-47, I.R.B. 1994-29**.

SECURED TRANSACTIONS

PRIORITY. The debtors had granted the plaintiff bank a security interest in all livestock and equipment. The debtors' son started a dairy operation and purchased a one-half interest in dairy cows with money borrowed from a second bank. The son granted the second bank a security interest in the cows, a purchase money security interest. When the son defaulted on that loan, the debtors took 15 of the son's cows and obtained a loan from the second bank to assume the payment for the cows, secured by a security interest in the cows and all other farm equipment and products and after-acquired replacement or new property. Nine years later, the debtors defaulted on their loans and the banks each asserted a priority security interest in the debtors' cows. The second bank argued that its purchase money security interest continued in the products and replacements of the original cows but conceded that it could not completely trace the original 15 cows to specific cows now owned by the debtors. Therefore, the court held that the priority of the purchase money security interest was lost as to the current cows. **Citizens Savings Bank v. Miller, 515 N.W.2d 7 (Iowa 1994)**.

STATE TAXATION

AGRICULTURAL USE. The plaintiff owned 88 acres of farmland within a city limits. The plaintiff had sold several parcels of land from the tract in past years for commercial development and had agreed that the land would only be sold to commercial developers in the future. However, the current use of the farmland was for growing agricultural commodities. The county assessed the land as commercial development property. The court held that because the plaintiff agreed that the highest and best use of the land was for commercial development and that the land would only be sold for commercial development, the land was not used solely for agriculture but was held solely for investment purposes and was to be valued at the commercial development value. The court stated that if the plaintiff had demonstrated an intent to indefinitely continue farming the land, the agricultural use valuation would be proper. **Telkamp v. S.D. State Bd. of Equalization, 515 N.W.2d 689 (S.D. 1994)**.

TRESPASS

TIMBER. The plaintiffs had purchased a wooded lot on which they built a residence. The trees on the lot were not used for harvesting or other business use. The defendant purchased a neighboring lot and cleared the lot of trees, removing some 10-20 trees on the plaintiffs' lot. The defendant argued that the value of the removed trees was the stumpage value because the trees were not grown for harvest and sale and were indigenous. The court held that the trees were ornamental and served the practical function of a dust, wind and visual screen for the plaintiffs' residence; therefore, the replacement value of the trees was to be used to calculate damages. The court also held that the award of treble damages was allowed because the defendant failed to conduct a survey, failed to locate boundary markers and failed to notify the plaintiffs of the proposed tree cutting in order to locate the true boundary. **Sherrell v. Selfors, 871 P.2d 168 (Wash. Ct. App. 1994)**.

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WORKERS' COMPENSATION

EMPLOYER. The plaintiff was an agricultural worker hired by a farm labor contractor who contracted with several farm owners, including the defendant, to provide temporary farm labor. The plaintiff was injured while working on the fields of the defendant on a temporary basis. The plaintiff was assigned to the defendant's fields and worked under the complete supervision of the defendant's foreman. The defendant had the right to reject a specific worker but could not fire the worker from employment by the labor contractor. The plaintiff received workers' compensation throught he contractor but sued the defendant for negligence. The defendant claimed that the plaintiff was a "lent employee" and the defendant was a "special employer" exempt from a suit for negligence under the workers' compensation law. The court held that the defendant exerted sufficient control over the plaintiff's work and the plaintiff had impliedly consented to the employment by agreeing to such control such that the defendant was the plaintiff's joint employer for purposes of workers' compensation. **Avila v. Northrup King Co., 871 P.2d 748 (Ariz. Ct. App. 1994)**.

ISSUE INDEX